Bonds Rally on Weaker Growth and Fed Patience

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

Bond yields moved lower today after a flurry of (mostly weak) economic releases, along with words of caution by the Fed Chairman signaling continued patience despite slowing growth. While some of this morning's numbers weren't quite as weak as forecasted, the disruptive tariff impact was evident in tepid consumer spending as well as shrinking business margins.

U.S. retail sales rose +0.1% last month, following an upwardly revised +1.7% jump in March. The deceleration suggests that pre-tariff, front-running of purchases was short-lived. This was particularly evident in sales of motor vehicles and parts, which surged +5.5% in March before slipping -0.1% in April. There was also a significant deceleration in electronics purchases, easing from +1.5% to +0.5%.

Control group sales, which exclude sales at gas stations, auto dealerships, building materials stores and eating and drinking establishments, fell -0.2% in April after advancing +0.5% and +0.8% in previous the two months. Given that the control group data is used to calculate GDP, it appears as though second quarter growth is off to a poor start. Sluggishness was widespread last month with sales in seven of 13 major spending categories declining, compared to just two in March. The retail sales numbers are seasonally-adjusted, but not price-adjusted. This hasn't been much of an issue with inflation receding, but is likely to become more impactful as the tariff effect settles in.

Given that the control group data is used to calculate GDP, it appears as though second quarter growth is off to a poor start.

In other news, manufacturing production fell -0.4% in April, the first factory decline in six months, while the April producer price index (PPI) showed the biggest single month drop in wholesale prices since the start of the pandemic in 2020. The -0.5% decrease follows an unchanged reading in March, which was revised upward from -0.4%.

A -1.7% drop in trade services (which measures wholesale margins) was a primary contributor to the surprisingly cool April PPI. The downturn indicates producers have not yet begun passing tariff costs on to consumers. The immediate result is reduced profit margins. Although tariffs are ultimately expected to boost prices on most consumer goods, significant increases have yet to materialize.

Today's bond rally suggests investors listened to Powell, expecting the Fed will likely remain on hold until September despite indications of slowing growth.

The next scheduled FOMC meeting is June 18th. Fed officials have emphasized patience as they seek clarity on the direction of inflation and the overall economy. This morning, in a speech outlining changes in the Fed's monetary policy framework, Chairman Powell warned that long term interest rates could remain higher in response to increased economic and price volatility resulting from more frequent and potentially persistent supply shocks. Powell went on to say that *it's premature to consider rate cuts.*

Today's bond rally suggests investors listened to Powell, expecting the Fed will likely remain on hold until September despite indications of slowing growth. Obviously, given the extreme uncertainty and related volatility, this outlook is subject to change.

Please see disclosure starting on page 2.

Market Indications as of 2:23 P.M. Central Time

DOW	Up 257 to 42,308 (HIGH: 45,014)
NASDAQ	Down -91 to 19,055 (HIGH: 20,174)
S&P 500	Up 18 to 5,910 (HIGH: 6,144)
1-Yr T-bill	current yield 4.10%; opening yield 4.13%
2-Yr T-note	current yield 3.96%; opening yield 4.05%
3-Yr T-note	current yield 3.95%; opening yield 4.05%
5-Yr T-note	current yield 4.07%; opening yield 4.17%
10-Yr T-note	current yield 4.45%; opening yield 4.54%
30-Yr T-bond	current yield 4.92%; opening yield 4.98%